

Accounting Versus Economics

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Definition: Accountant (n.); a manipulator of business statistics whose robotic behavior leads impartial observers to assume that he lacks the imagination and personality to be an economist.

Definition: Economist (n.); a personality whose manipulation of business statistics and imaginative observations about human behavior reveal a lack of impartiality and accountability.

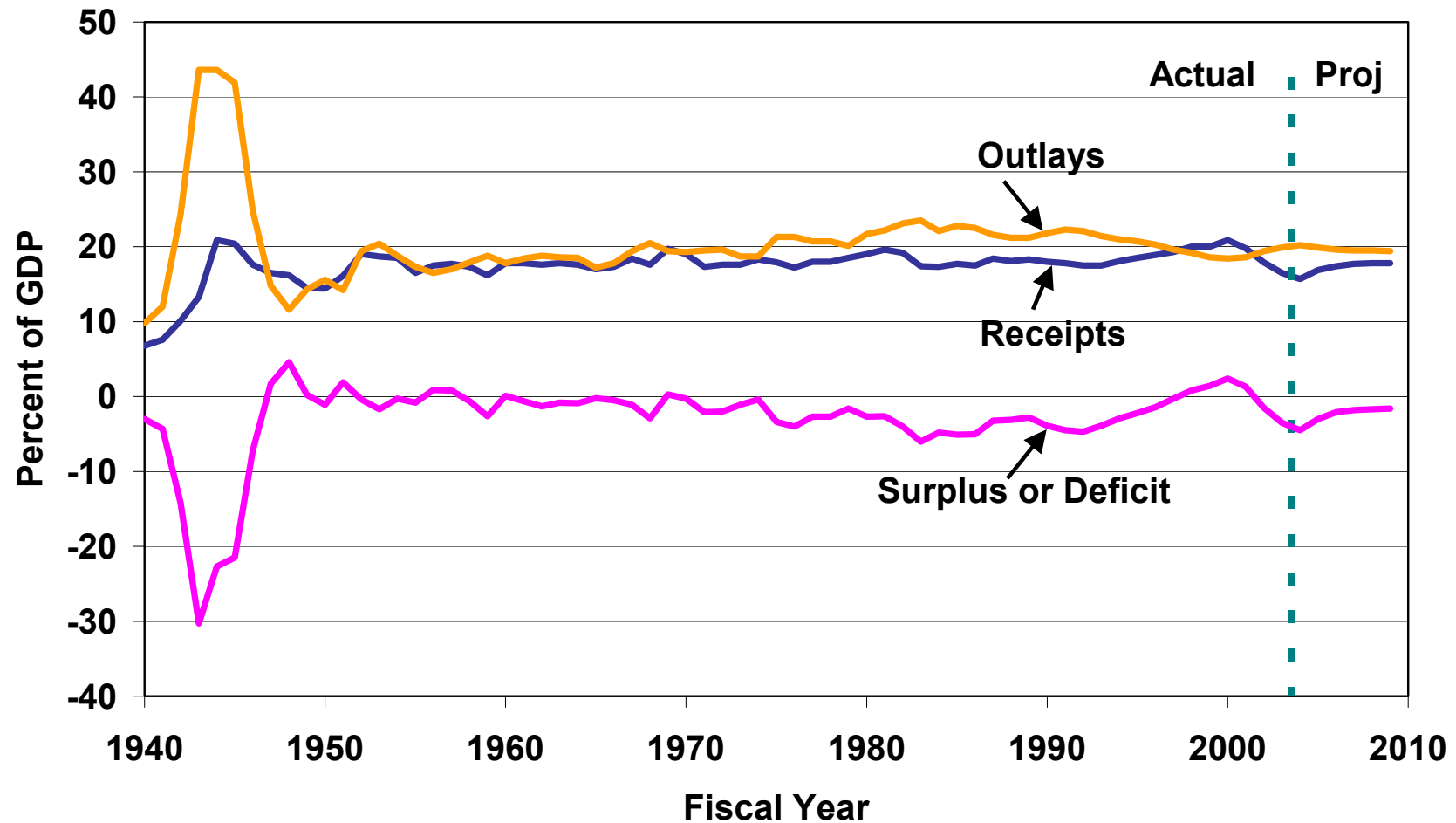
Definition: Public Finance Specialist (n.); A national income and product accountant who styles himself an economist and displays the attributes of both professions.

Receipts, Outlays, And Deficits (As % of GDP)

	Period			
	1947-1967	1968-2000	2001-2003	2004-2009
Average Outlays	17.3	20.8	19.3	19.7
Average Receipts	17.2	18.4	18.1	17.2
Average Deficits	-0.1	-2.5	-1.2	-2.5

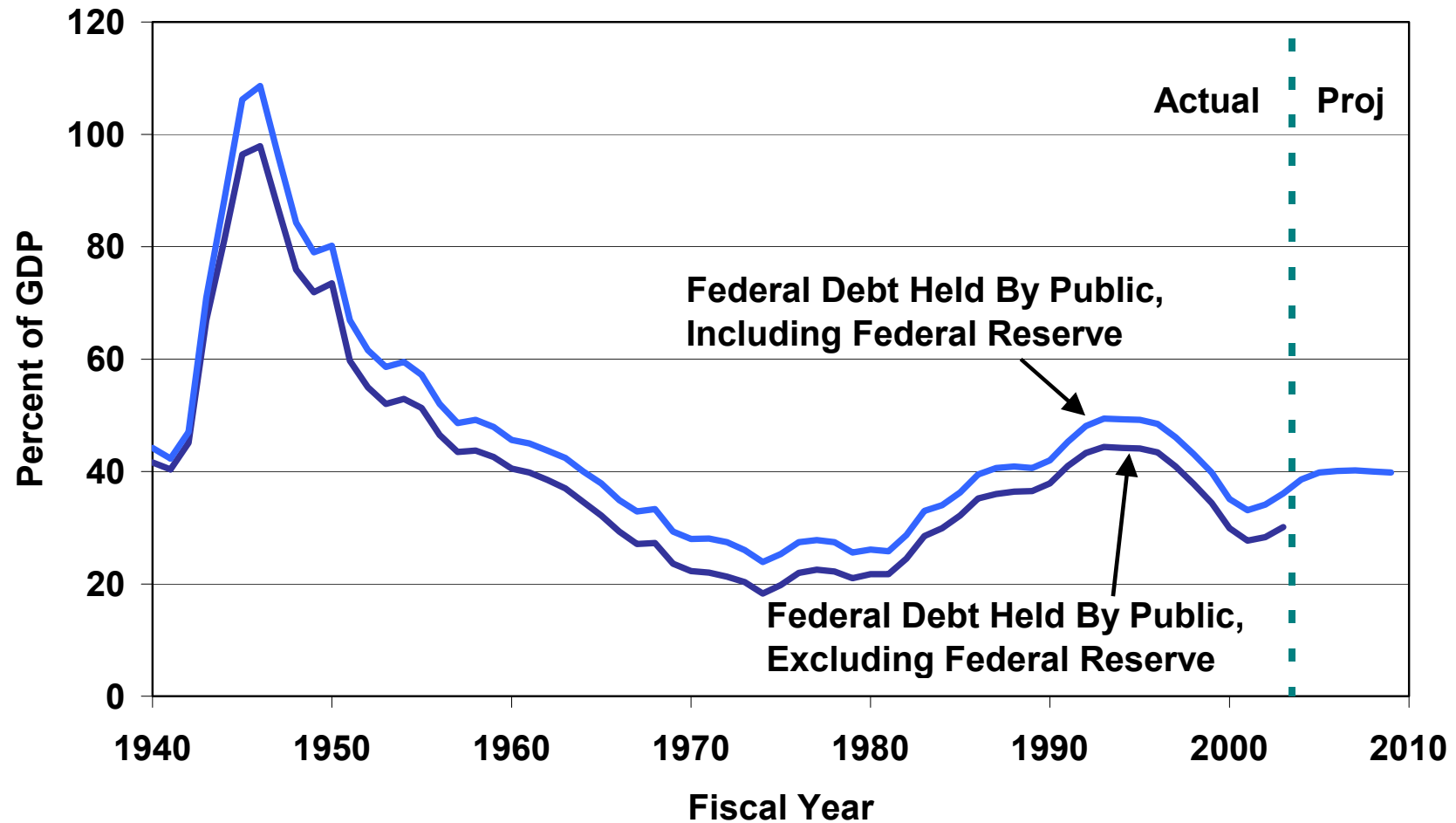
Source: U.S. Budget, FY 2005, Historical Tables, Table 1.2

Receipts, Outlays, And Deficits (% of GDP)



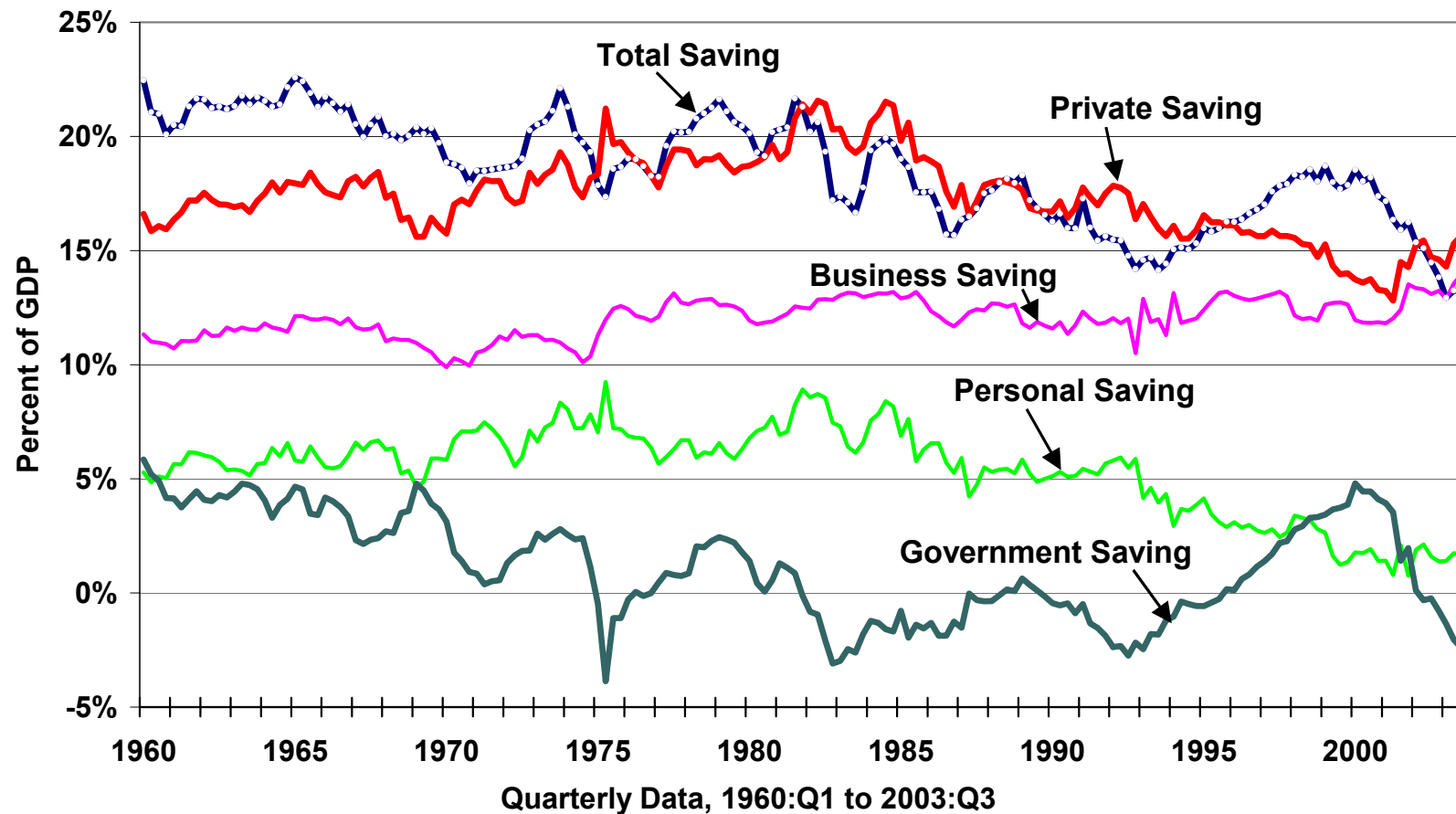
Source: U.S. Budget, FY 2005, Historical Tables, Table 1.2

Federal Debt Held By Public



Source: U.S. Budget, FY 2005, Historical Tables, Table 7.1

Government Saving Versus Private Saving



Sources: NIPA data from Bureau of Economic Analysis (accessed at www.bea.doc.gov); Chart based on Gary Robbins and Aldona Robbins, "Robbing Peter to Pay ... Uncle Sam," *Economic Scorecard*, 2nd Quarter, 1999, Institute for Policy Innovation, accessed at www.ipi.org.

The national income and product account GNP identity is:

$$\mathbf{C+I+G+(X-M)=C+S+T}$$

Our income earned by producing and selling products and services (consumption goods and services, investment goods, government goods, and net exports) equals what we use our income for (consuming, investing, and paying taxes). True. It has to be, by definition. It says nothing about what makes the elements change, or how one element will change if another one is altered.

Cancel out the consumption, and write the identity as:

$$\mathbf{I=S+(T-G)+(M-X)}$$

"Investment equals private saving plus the government surplus plus the excess of imports over exports (the capital inflow)." True. "So, if we cut taxes or increase government spending, thereby lowering the budget surplus, investment must fall by the same amount, and if we raise taxes, lower government spending, thereby raising the budget surplus (or lowering the deficit), investment must rise by the same amount." False. It assumes S and (M-X) are constant in spite of tax and spending changes.

Rewrite the identity as:

$$\mathbf{(I-S)+(G-T)=(M-X)}$$

"If we spend more on investment than we save, and spend more on government than we raise in taxes, then imports exceed exports." True. "So an increase in the budget deficit due to a tax cut or government spending hike will increase the trade deficit (or rather, the current account deficit) by the same amount (the twin deficits)." False. It assumes saving and investment are constant when taxes and government spending change.

Reality: The desired capital stock varies inversely with the cost of capital, which is in part a function of the marginal tax rate on capital. Investment therefore varies inversely with the tax rate. Saving is a function of the after-tax rate of return on saving, which in turn is affected by taxes on saving and by the after-tax return on physical investment.

Raise incentives by reducing taxes at the margin on investment or saving, as by reducing the corporate income tax, increasing depreciation write-offs, lowering marginal tax rates, cutting the tax rate on dividends or capital gains, and saving and investment will rise. The budget deficit may well rise, but added GDP will create some revenue reflow. Depending on whether domestic saving rises by more or less than the budget deficit plus the rise in investment (probably less), the capital inflow and the current account deficit (trade balance plus investment income balance plus transfers) may fall or rise (probably rise). Any increase in the current account deficit will be a result of stronger domestic investment and GDP, not a cause of weaker domestic output.

Raise the budget deficit by raising government spending, however, and more manpower and physical "stuff" is drawn away from production of investment goods or goods for domestic consumption or export. To the extent saving does not rise to cover the added government borrowing, there will be some drop in investment and some rise in the current account deficit. The increase in the current account deficit will be a reflection of a smaller private sector. Spending is the villain here, not the budget deficit per se.

Raise taxes at the margin on investment or saving, as by increasing the corporate income tax, lowering depreciation write-offs, raising marginal tax rates, increasing the tax rate on dividends or capital gains, and saving and investment will fall due to reduced after-tax rates of return. The budget deficit may fall, but that won't help restore incentives for investment and growth. The reduced GDP will dampen the revenue rise. Depending on whether saving falls by more or less than the deficit reduction and drop in investment, the capital inflow and the current account deficit will rise or fall. A (probable) fall in the current account deficit would be the result of a weaker private sector, not a source of private sector strength.

Cut the budget deficit by cutting spending, however, and more workers and material are available to make investment goods and goods for domestic consumption or export. There will be some increase in investment and some reduction in the current account deficit. Incentives and reduction in spending, not the budget deficit per se, are the key to expanding the private sector.